

November 4, 2004

W. Kenneth Ferree
Chief, Media Bureau
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: MB Docket No. 04-207

Dear Mr. Ferree:

Sound analysis, based on long-established and fundamental economic principles, demonstrates that a government requirement that cable and direct broadcast satellite (DBS) television programming be available to customers on an *a la carte* basis would very likely raise prices and harm consumers. Several such analyses have been submitted in the current proceeding, including those conducted by the undersigned economists. Although these analyses differ with respect to certain details, all reach the same fundamental conclusion: government-imposed *a la carte* distribution would very likely harm consumers, programmers, multi-channel video programming distributors (MVPDs), and economic efficiency. These harms would arise even if the government permitted multi-channel providers also to offer discounted programming bundles.

In their submissions, Consumers Union and the Consumer Federation of America (CU/CFA) claim that mandatory unbundling is good public policy. These submissions, however, are based on fundamentally flawed claims, which are grounded in neither sound economic theory nor empirical evidence. We are writing jointly to emphasize the seriousness of the errors in several of these claims and the need to apply proper economic analysis to them.

In this brief letter, we touch on only a few of the most important and misleading errors:

- *CU/CFA submissions misconstrue the economics of bundling and contain no meaningful analysis of the equilibrium effects of government-imposed a la carte distribution.* The CU/CFA submissions fail to recognize the efficiency benefits of bundling. They also fail to understand that these benefits may arise whether or not suppliers have market power. A central feature of sound economic analysis is that it traces through the full effects of a policy by determining how it affects equilibrium outcomes. Instead of following this methodology, the CU/CFA submissions simply make unsubstantiated assertions that lack logical and factual bases.

In contrast, the undersigned economists have conducted analyses that focus on the price, output, and program diversity consequences—whether intended or not—of *a la carte* requirements. These analyses demonstrate the harms of government-imposed *a la carte* distribution.¹ Consumers, in particular, would be harmed through several different effects of government-mandated *a la carte* distribution, including the following: (1) mandatory *a la carte* distribution would very likely raise overall prices;² (2) consumers' viewing decisions would very likely be distorted and their ability to sample alternative networks and shows would very likely be suppressed; and (3) mandatory *a la carte* distribution would very likely harm new and niche networks,³ which would result in fewer viewing options for consumers.⁴

- *CU/CFA submissions overstate the alleged benefits of a la carte distribution.* The CU/CFA submissions assert that bundling forces consumers to pay for programming they do not watch. Economic analysis of the MVPD industry, however, demonstrates that this claim is a myth.⁵ This argument ignores the

¹ See, e.g., Gustavo Bamberger, *Statement of Gustavo Bamberger*, July 14, 2004; Michael G. Baumann and Kent W. Mikkelsen, *Benefits of Bundling and Costs of Unbundling Cable Networks*, July 15, 2004; Thomas W. Hazlett, *The Economics of Cable TV Pricing: A La Carte v. All-You-Can-Eat*, August 12, 2004; Michael Katz, *Slicing and Dicing: A Realistic Examination of Regulating Cable Programming Tier Structures*, July 15, 2004; Michael L. Katz, *Wrong Diagnosis, Wrong Cure: An Analysis of the Claims Made by Dr. Mark Cooper in "Time to Give Consumers Real Cable Choices"*, August 8, 2004; and Bruce M. Owen and John M. Gale, *Cable Networks: Bundling, Unbundling, and the Cost of Intervention*, July 15, 2004.

² Overall prices would be expected to rise for a number of reasons. First, overall costs would rise: distribution and marketing costs for operators and programmers would rise due to the complexity of *a la carte* distribution, while programming costs would not decrease unless programming quality significantly declined. Moreover, because of the distortions in viewer behavior that government-imposed *a la carte* distribution would induce, overall cable and DBS television viewing would fall. This fall would reduce opportunities for programmers and MVPDs to generate advertising revenues that would otherwise offset their costs. Consequently, programmers and MVPDs would have economic incentives to set higher prices.

³ "The overwhelming opposition of programmers is based on a crucial economic consideration: *each cable network needs to get its programs to where viewers can see them, and imposing a la carte will make that harder.* Providing customers with a large bundle of channels for a standard monthly fee has delivered exceedingly important efficiencies, and forcing customers to order one network at a time would eliminate those advantages." (Thomas W. Hazlett, *The Economics of Cable TV Pricing: A La Carte v. All-You-Can-Eat*, August 12, 2004 at 30.)

⁴ "[T]he imposition of *a la carte* pricing likely would reduce the number and diversity of available networks, or reduce the quality of programming shown on those networks (or both). For the same reasons (e.g., likely lower advertising and license fee revenues), fewer networks likely would be launched in the future." (*Statement of Gustavo Bamberger*, July 14, 2004 at 6.)

⁵ See, e.g., Thomas W. Hazlett, *The Economics of Cable TV Pricing: A La Carte v. All-You-Can-Eat*, August 12, 2004 at 23 ("While it appears that subscribers are being charged for programs they *do not* demand, the fact is that they only pay the subscription fee if the value of the programs they *do* demand exceeds the fee. In reality, they only pay for the tier programs they desire to receive, and the cable operator throws the additional channels in for free.").

fundamental fact that it is costly to exclude a cable subscriber from receiving selected networks. In fact, once one takes into account the effects on the supply of programming available to cable and DBS operators, economic analysis shows that the use of program bundles can lead to situations in which *every* consumer *pays less and receives more* programming than he or she would under a mandatory *a la carte* scheme.⁶

- *CU/CFA submissions understate the costs of a la carte distribution.* CU/CFA offers no serious analysis of the costs of the more sophisticated set-top boxes, complex billing systems, and greater customer service demands that mandatory *a la carte* distribution would impose. In fact, as shown by numerous filings, mandatory *a la carte* would significantly increase distribution costs.
- *CU/CFA submissions consistently confuse system capacity and carriage decisions with bundling, and their projections of the effects of mandatory a la carte distribution on network variety are exactly backwards.* If a media conglomerate has enough bargaining power or desirable enough programming to induce MVPDs to carry multiple networks from that programmer, then those incentives exist whether MVPDs offer their programs in bundles or on an *a la carte* basis. Mandating *a la carte* distribution would do nothing to increase scarce system capacity. In fact, by diverting dollars and managerial efforts to complex and expensive billing system modifications and other changes needed to support *a la carte* distribution, mandatory *a la carte* distribution might slow the growth of channel capacity which could otherwise allow a wider array of programming to be offered to consumers. And, as noted above, there are many additional reasons why programming diversity would be harmed by mandatory *a la carte* distribution.

Confusion about the relationship between bundling and programmer bargaining power is related to another point of confusion in the debate over unbundling. So-called “voluntary” *a la carte* distribution is nothing of the sort. Under some proposals for “voluntary” unbundling, programmers would not be allowed to: (a) negotiate whether their programming was offered in tiers or on an *a la carte* basis; or (b) require MVPDs to purchase multiple networks in a bundle. Such a policy could abrogate existing contracts, thus undermining investments made in reliance on these contracts and triggering the need for costly renegotiation. Moreover, government-imposed restrictions on the freedom of programmers and MVPDs to reach contracts on terms of their choosing would very likely lead to inefficient

⁶ See, e.g., Michael Katz, *Wrong Diagnosis, Wrong Cure: An Analysis of the Claims Made by Dr. Mark Cooper in “Time to Give Consumers Real Cable Choices,”* August 8, 2004, Appendix.

outcomes and harm to consumers.⁷ Lastly, for reasons similar to those stated in the next bullet, an unbundling requirement could lead to regulation of the prices that programmers charge to MVPDs, which would be an unwarranted imposition of government control.

- *CU/CFA's call for mixed bundling is really a disguised call for cable rate regulation.* If MVPDs were forced to offer *a la carte* options, they could do so in such a way as to induce consumers to continue choosing current bundled options. For example, an MVPD could offer a package of programming for \$40 per month and offer each channel within the package on an *a la carte* basis for \$35 per month per channel. Such pricing would constitute mixed bundling, which is the pricing structure the CU/CFA submissions advocate. If the aim of the mandatory unbundling proposals is to change the way MVPDs sell video programming to consumers, rather than merely to give consumers a nominal *a la carte* option, *a la carte* supporters—such as CU/CFA—are implicitly calling for some form of price regulation. It is well established that regulating cable rates is an extremely difficult process that inevitably results in unintended adverse consequences for consumers and economic efficiency.

In conclusion, sound economic analysis demonstrates that government-imposed *a la carte* distribution—whether labeled “voluntary” or not—would harm consumers, programmers, MVPDs, and overall economic efficiency. The unsubstantiated and often illogical claims made in the CU/CFA submissions do nothing to change this fact.

Respectfully,

Gustavo Bamberger
Lexecon

Michael G. Baumann
Economists Incorporated

John M. Gale
Economists Incorporated

⁷ If a program network's business plan and viability depend on the network's being carried on a widely distributed tier, the network may need to be able to negotiate for the right to such carriage from MVPDs before committing to significant programming expenditures. A governmental restriction on the ability to negotiate for such assurance would thus harm the ability of the network to provide programming that consumers might highly value.

W. Kenneth Ferree
November 4, 2004
Page 5

Thomas W. Hazlett
Manhattan Institute for Policy Research and
University of Pennsylvania

Michael L. Katz
University of California, Berkeley

Kent W. Mikkelsen
Economists Incorporated

Bruce M. Owen
Stanford University